EQUITY MARKET UPDATE

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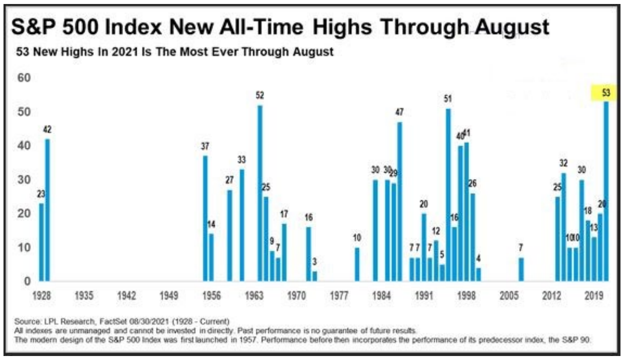
Stocks rose in August for the seventh straight month. The gains came despite numerous warnings that the global economy has slowed due to the spread of the Delta variant. Investors continue to debate the potential for future inflation, while the Federal Reserve had further discussions on tapering monthly asset purchases. On the political front, China expanded their regulatory crackdown on big tech companies, while the US Congress tried to pass an increase in the debt ceiling, along with both physical and human infrastructure bills. All these events resulted in further retracement in yield for the 10-year US Treasury, which aided growth stocks.

<u>Tech Rally Pushes Stocks to All-Time Highs</u>

The S&P 500 gained 2.90% in August. The index was powered by a combination of big tech companies and defensive sectors, like utilities, REITs, and communications. Energy declined, while industrials, materials, and consumer discretionary stocks also underperformed. Year-to-date, the S&P 500 is up 20.41%; however, the average stock is up only 3% since May if you exclude the large tech stocks. The index has hit all-time highs 53 times so far in 2021, the most ever for the index through eight months.



The Dow Jones Industrial Average increased by 1.22% last month. A lower allocation to technology, along with sharp declines in Visa, Amgen, and Boeing accounted for the underperformance versus the S&P 500. Year-to-date, the Dow is up 15.53%.

The NASDAQ was the strongest performer among the major indexes gaining 4.00%. After experiencing investor outflows for most of the year, tech stocks have been the market darlings since June due to the spread of the Delta variant and Fed discussions about tapering monthly asset purchases. Large advances in Apple, Microsoft, Amazon, Alphabet, Facebook, and NVIDIA accounted for 60% of the gains. Despite the strong month, the NASDAQ still trails the S&P 500 in 2021 with a total return of 18.40%.

Just like last year, the increase in COVID-19 infections has caused mid-to-small sized companies to underperform their larger peers. The S&P 400 Mid-Cap Index gained 1.83%, while the S&P 600 Small-Cap Index increased 1.90%. Both indexes were hurt

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409-600-6460

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by an overallocation to economically sensitive sectors; however, the small-cap index continues to benefit from meme stocks, like AMC Entertainment and GameStop, as retail investors chase ideas being spread on the social media platform Reddit. Thus far in 2021, mid and small-sized companies have rallied 19.36% and 22.15%, respectively.

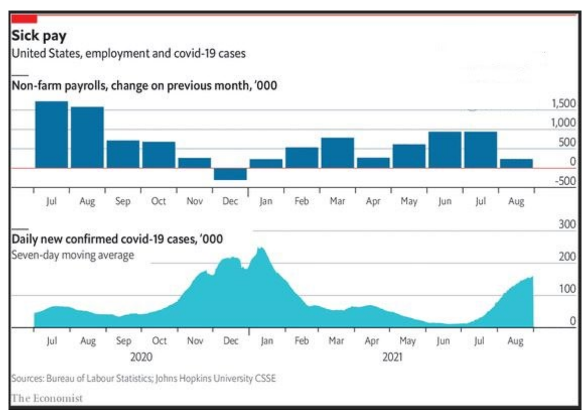
International & Emerging Market Stocks Rally but Trail US Indexes YTD

The Eurozone reopening continued with GDP growth of 2%. Tourism-heavy countries, like Spain and Italy, posted much stronger results. The IHS Markit European PMI Index hit its highest level since 2000 on further strength in services, while manufacturing continued to expand despite supply chain challenges. The European economy is gaining steam as 70% of eligible EU citizens are fully vaccinated against COVID-19. Unfortunately, economic results in Japan remain mixed as the government expanded COVID-19 restrictions to slow the spread of the Delta variant, and Japanese Prime Minister Yoshihide Suga announced he would step down after just one year in office. The MSCI EAFE Index increased 1.52%. Year-to-date, the index is up 9.73%.

The MSCI Emerging Markets Index gained 2.42% in August even though Chinese economic activity slowed. The Manufacturing PMI Index fell to 50.1, barely above the 50 level that separates expansion from contraction. Meanwhile, China's Non-Manufacturing PMI entered contractionary territory with a reading of 47.5, its lowest level since the start of the pandemic. Heightened restrictions for COVID-19, along with further supply chain disruptions weighed on results. Finally, the Chinese government continued its crack down on large tech companies after President Xi unveiled his five-year plan to further regulate large parts of the economy. Actions have included a ban on school age children playing video games during the school week, limiting the time and amount families spend on after-school tutoring, requiring large Chinese tech companies to get government permission before listing their stock in overseas markets, and banning the data of Chinese consumers from being stored on foreign servers. Year-to-date, emerging markets remain the weakest performer gaining only 1.35%.

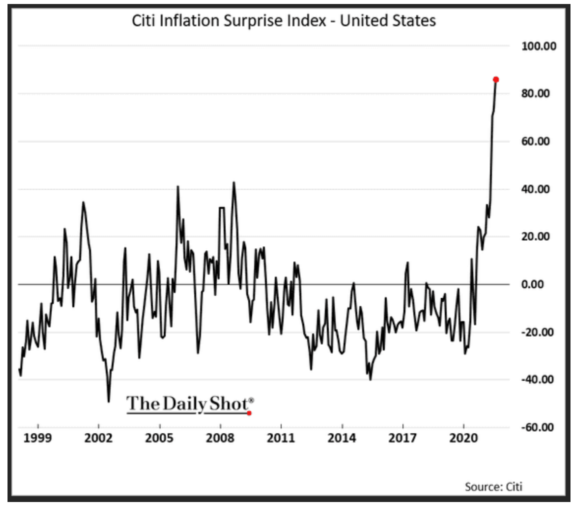
Delta Variant of COVID-19 Spreads Across the US

The Delta variant of COVID-19 that originated in India continued its spread with increasing speed. Scientists say the mutation is more transmissible than the original strain of COVID-19. Infections rose in many parts of the world, especially in regions where vaccination rates were low. In the United States, the worst results were seen throughout the South, where vaccination rates were far below the national average. Even though the Delta variant can result in breakthrough cases for the fully vaccinated, the likelihood for hospitalization and death are very low when compared to the effects on the unvaccinated. Numerous models indicate we are nearing the peak in new daily infections from the Delta variant. However, as we enter the colder months, President Biden announced booster shots would become available starting in late-September for people who are more than eight months passed their last shot to strengthen antibodies against future mutations. All approved COVID-19 vaccines continue to show great efficacy against all strains of COVID-19, and there is ample supply available for Americans who have yet to be vaccinated.



US Economy Slows Due to Delta Variant and Fed Continues Taper Talks

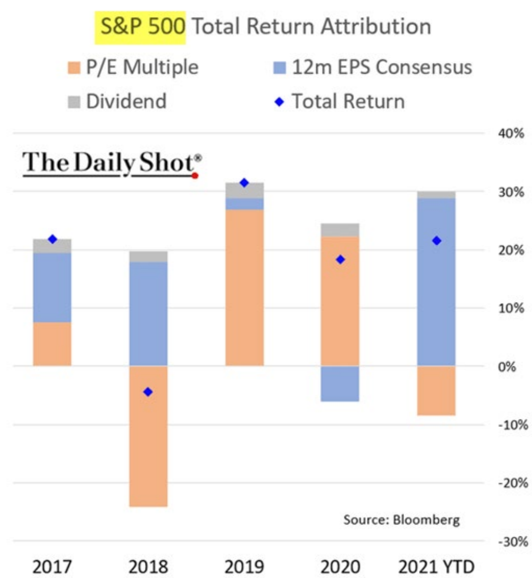
Economic data showed further improvement in August; however, the pace of growth slowed dramatically. Non-farm payrolls increased by only 235,000 jobs. This was a significant drop from the previous two months which registered almost 2 million jobs. The spike in Delta variant cases was largely to blame as hotels, restaurants, and retail posted the weakest results. Labor force participation remained flat, but data showed improvement among prime aged workers (25-54 years old). Both US Manufacturing and Service PMIs declined slightly, although both remain firmly in expansion territory. Supply chain issues remain problematic as order backlogs and delivery times are stretched. Inventories for many products are still at low levels with the most acute shortages occurring in automobiles. This is pushing up prices at both the producer and consumer levels.



Hotter than expected inflation readings has placed outsized attention on the Fed. The FOMC left monetary policy unchanged during its July meeting, and Federal Reserve Chair Jerome Powell continues to reiterate that inflation is transitory as the economy reopens. He indicated during his Jackson Hole address that a tapering of monthly bond purchases could start this year; however, he stressed the timing of tapering remains flexible, and the decision to taper does not impact when to start raising rates. Given the slowdown in economic activity last month, especially in payroll data, it is likely the Fed will hold-off on tapering until they get better visibility into whether the economy reaccelerates once Delta cases drop.

Market PE Remains Elevated Despite Robust Earnings Growth

Currently, the S&P 500 trades at 22.25x 2021 EPS estimates. This is far better than the 27.01x trailing earnings reading, and it shows how rapidly corporate profitability has improved. The 2nd quarter earnings season was especially strong with 87% of companies beating sales estimates and 90% beating earnings estimates. Even more impressive was year-over-year earnings growth of 90.1%. According to FactSet, this was the 2nd highest yearly growth rate ever for the S&P 500, just behind the 4th quarter of 2009 (109.1%).



Despite the improved earnings, stock valuations remain pricey. If you fast forward to the 2022 and 2023 profit forecasts, the index trades at 20.46x and 18.64x, respectively. All these valuations are well above the historical median of 16.69x, and they do not consider President Biden's proposed tax increases.

The above average valuations can be justified by the enormous amount of liquidity in the system. Extremely accommodative financial conditions, along with the drop in 10-year US Treasury yields from 1.77% to 1.32% in the past few months, are providing fuel to the stock market rally. The recent decline in interest rates has been a boon to the pricey tech stocks. Given the tech sector's large weight in the S&P 500, the rally has pushed the market's PE ratio even higher.

All these indicators signal the market has baked-in much of the upcoming improvements for the economy; therefore, stocks are vulnerable to further consolidation or pullbacks in the next few months. We expect volatility to remain high among sectors as the effects of stimulus wane, the Fed begins tapering asset purchases, and daily infections of COVID-19 decline.

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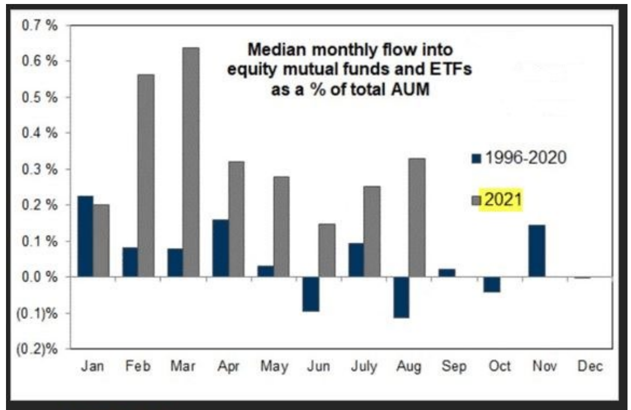
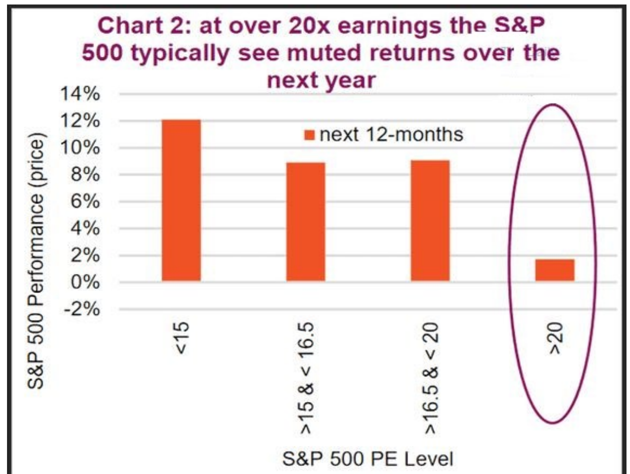
Our Outlook & Strategy



Source: Goldman Sachs



source: Richardson Wealth

The stock market has operated under two very different climates thus far in 2021. For the first five months, investors' willingness to take risk was high, and they preferred the most economically sensitive stocks. That trend has reversed itself during the summer months as the Delta variant spread across the globe and consumers spent their stimulus checks. This led to a rotation towards quality, which has aided our portfolios.

As autumn approaches, many questions need to be answered. First, is the recent deceleration in economic activity purely a function of the Delta variant, or have consumers spent all their stimulus funds? Will the Fed begin to taper asset purchases this year, and is that good or bad for stocks? Will Congress pass legislation that increases taxes, and what effect does that have on future earnings? Is inflation really transitory, or has the pandemic exposed weaknesses in global supply chains that will lead to longer term price pressures? The answer to those questions will have a significant impact on both the direction of the overall market and the stocks that serve as leaders.

Until we get further clarity on those items, the vast amount of liquidity in the system must find a home. We are seeing a record amount of inflows into the stock market despite the elevated valuations. With negative real yields (the rate on a bond minus the inflation rate) and historically tight credit spreads in the bond market, stocks are finding little competition, which is pushing equity valuations higher.

This tells me the yield on the 10-year US Treasury has become the most important price indicator in the world. The correlation between bonds and stocks is high; therefore, providing less diversification benefits than the past. The excess liquidity is inflating all assets to levels that have historically indicated below average forward one-year and five-year returns. This means volatility will likely remain high, especially since the market is currently in its second longest period in history without a pullback of more than 5% off the highs. It also makes inflation readings very important to watch. The future path of interest rates and the speed in which they change will determine whether growth (led by technology) or value (led by financials and energy) will serve as market leadership.

The effects of COVID-19 have created a new "normal" for investors to consider. We have accelerated the time frame on the use and adoption of mobile technologies for education, shopping, entertainment, doctor visits, etc. We have also adapted to a non-centralized workforce. We have seen from the past two administrations that the United States wants to encourage domestic manufacturing of semiconductors, medical equipment, and other items deemed to be of national security importance. Finally, the rush to develop a vaccine has brought many new healthcare related technologies to marketplace. When considering all these items collectively, the Fed is likely correct that total inflation will prove to be transitory as productivity rises from these technological innovations; however, a misallocation of workers and skillsets increases the likelihood that certain pockets of the

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economy will see above average inflation for many years.

As we evaluate our roster of holdings across our equity styles, we remain highly selective about which companies to own. We are constantly searching for companies that will benefit from long-term secular trends that can produce top-line revenue growth and sustainable cash flows. This naturally leads to overweight positions in technology and healthcare. These stocks are negatively impacted when interest rates rise, so we have been boosting our holdings in energy and financials to offset this risk should inflation readings remain hot for longer than expected.